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TAGS: ECON ETRD EINV EIND AS
SUBJECT: CHINESE INVESTMENT OFFERS PILE UP IN AUSTRALIAN
MINING SECTOR

REF: CANBERRA 143

Classified By: Economic Officer David Atkinson, Reasons 1.4(b)(d)

¶1. (C) Summary: The pace of Chinese efforts to invest in key Australian mineral companies has picked up. While the Chinalco-Rio Tinto investment (reftel) has drawn the most attention, other Chinese companies are seeking to take advantage of the troubled economic state of many Australian miners. The involvement of China's sovereign wealth fund in financing at least some of these plans will increase suspicions and make a GOA approval more complicated. The GOA must now rule on Chinese investments in some of the largest diversified mining companies in Australia as concerns about jobs and a long-lasting recession spread. Opposing the bids could lead to mine closures, job losses and a shortage of capital investment in the sector, to say nothing of damaging relations with China. Approval would risk not only rising angering Australians, but could increase China's influence on resource pricing and corporate management in the country's flagship industry. End Summary.

CHINESE INVESTMENT PROPOSALS

¶2. (SBU) The Australian resources and energy sector has been hard hit by the global economic crisis and falling commodity prices - especially those companies that are highly leveraged and find themselves having to sell assets to raise cash in a buyer's market. The depreciation of the Australian dollar from nearly US$1.00 in June/July 2008 to about US$.64 (with a similar decline against the Chinese yuan) now has made Australian companies cheaper in local currency. Australian resource players will see their revenues further weaken when the current high prices from early 2008 contracts end over upcoming months as new contracts are negotiated.

¶3. (SBU) Chinese companies Chinalco and Minmetals are seeking to buy large shares in Rio Tinto and OZ Minerals, two of the three biggest miners in Australia. The first bid involved an $A30 billion, 18 per cent share in Anglo-Australian mining giant Rio Tinto, while the $A2.7 billion Minmetals bid would be for full ownership of the smaller OZ Minerals. In earlier decades, Japanese resources investment in Australia focused on joint ventures and minority shares in projects but Chinese investors are also consumers of the minerals that are produced, raising concerns about non-price factors affecting resource contract negotiations.

¶4. (SBU) Under the Chinalco-Rio Tinto bid, Chinalco would own up to 50 per cent of the Hammersley iron ore mine and 50 per cent of the Yarwun bauxite project - which could easily extend to effective control. Minmetals' bid for OZ Minerals would involve the 100 per cent acquisition of a range of major mining assets from OZ Minerals, including Khanong Copper for A$900 million; Sepon gold and copper (A$47 million); the Prominent Hill copper and gold mine (A$1.1 billion; Century Zinc (A$948 million); Rosebury polymetallic (A$285 million); Dugald River lead and zinc (A$190 million) and Avebury nickel (A$515 million). Also looming on the
Qand Avebury nickel (A$515 million). Also looming on the horizon is a tentative discussion between Australian number three iron ore producer Fortescue and Hunan Valin Iron and Steel. Although Hunan was careful to say these talks were at early stages, Fortescue's troubled financial situation suggests that the time is right for an injection of foreign capital.

THE FOREIGN INVESTMENT ASSESSMENT PROCESS

¶5. (U) Treasurer Wayne Swan has the power to reject any foreign investment proposal on national interest grounds, which are not specifically defined. The Foreign Investment Review Board (FIRB) advises the Treasurer, and is expected to make a recommendation by April on the Chinalco bid, but may have to act sooner on the Minmetals offer because OZ Minerals is on the brink of bankruptcy.

¶6. (SBU) In July 2008, Swan told Chinese steel producers that their plans at the time to acquire mining companies would attract heightened scrutiny. He said the GOA wanted to ensure that market forces, rather than foreign interests, govern the development of the resources industry. At the time, Swan also said that the government would look carefully at plans by companies that use Australian resources to acquire suppliers; if the acquirer could affect pricing or production, the GOA would consider opposing the deals on national interest grounds. In September 2008, Swan approved the application by Chinese government-owned Sinosteel to buy up to 49.9 per cent of Murchison Metals, saying that the development of potentially significant new resource areas should be open to "multiple investors". However, approval of Chinalco's previous acquisition of a nine per cent stake in Rio Tinto was delayed for six months.

¶7. (C/NF) In February 2009, Swan announced changes in foreign investment laws shortly after the Chinalco deal was unveiled, signaling the GOA intended to scrutinize the deal closely. In response to Rio Tinto's announcement that it would issue convertible bonds to Chinalco, Swan announced that the government would amend legislation to ensure that investments made via convertible notes would be subject to foreign investment laws. One reason for Chinalco's use of commercial paper to fund the acquisition of part ownership in some of Rio Tinto's aluminum and iron ore assets is to take ownership without control over these assets. However, another motivation is to avoid capital gains tax on the transaction, which could be considered as against the national interest by Swan and the GOA. Rejecting the proposal on the grounds of preventing tax avoidance could be a politically less controversial way of blocking the investment.

CONCERNS EXPRESSED OVER CHINESE INVESTMENT

¶8. (U) Many politicians, normally in favor of foreign investment, have expressed concern over the Chinese investment proposals. This concern is echoed in the general populace and media. Western Australia Premier Colin Barnett wants more controls over Chinese investment in Australia and said he would prefer small, stable investments from Chinese steel mills and Chinese investment groups to facilitate long-term relationships. Federal Opposition resources spokesman Ian Macfarlane called for careful scrutiny of the deals and said there were genuine concerns about the Chinese

Government's ownership of Chinalco - or indeed, over any foreign government holding significant equity stakes in major companies because of the potential for sensitive information to pass through the government to other commercial players. Macfarlane said this was particularly important in the case of Rio because of its strategic iron ore and coal holdings in Australia and copper resources. Former Treasurer Peter Costello, who only vetoed one foreign investment bid in eleven years as Treasurer (the Shell bid for Woodside Petroleum in 2001), used the Chinalco bid as a platform to reenter political debate in Australia by calling on the government to reject the bid.

¶9. (SBU) Another concern for Australian mineral players is the upcoming renegotiation of future iron ore and other mineral contracts with China. Australian miners are still getting mid-2008 prices for their commodities. Chinese officials have indicated they will be looking for price cuts of around 30-50 percent for iron, and the elimination of the freight premium Australian miners currently enjoy. Some fear that greater Chinese access to Australian companies will give Chinese companies - and the Chinese Government - an advantage in subsequent price negotiations.

"POLITICAL BLACKMAIL" AND THE CHINALCO BID

¶10. (SBU) Rio Tinto said failure to approve the $US19.5 billion (A$30.4 billion) Chinalco package could cost 2150 existing jobs. According to Rio, the contractor and employee cuts would be in addition to Rio's already announced 14,000 targeted global job cuts, bringing the total cut from its Australian workforce to 5000 if the deal fell through. Rio, essentially daring the GOA to reject the bid, has specified that all but 100 of the job cuts would be in Queensland, home state of Prime Minister Kevin Rudd and Swan. This is especially sensitive since Queensland will probably hold a state election, possibly in March 2009. Queensland Premier Anna Bligh has called for approval of the bid. The Australian Workers Union has accused Rio management of political blackmail. Other states also have an interest in the proposals; for example the Prominent Hill site is important to the South Australian economy. It is also adjacent to the Woomera aerospace testing range, raising the possibility that approval there would involve security issues and input from the Defence Minister as well. However, the investment proposals have received some support. Concept Economics executive director Brian Fisher said concerns about the deal were misplaced because Chinalco planned to take a relatively small stake in Rio, and the investment would be a capital injection that would support jobs.

CONDITIONAL LIMITS TO FOREIGN INVESTMENT

¶11. (SBU) Swan could decide to approve the Chinalco and Minmetals bids with conditions. For example, he could require a commitment that Chinalco would not interfere in the management of Rio Tinto - but there is some irritation within the GOA over Rio's track record on previous commitments to the FIRB that were later reneged on. Notably, former Treasurer Costello has called on the Rudd government to block Chinalco's attempt to increase its stake in Rio Tinto. Costello said that any assurance Rio Tinto or Chinalco might give about maintaining an Australian presence would be hard to police or enforce because the Anglo-Australian company is based in London.

CHINESE SOVEREIGN WEALTH FUND INVOLVED?

¶12. (SBU) The GOA will also closely scrutinize the use by Chinalco and Minmetals of a Chinese sovereign wealth fund to finance direct investment in Australian resources. Previously, the GOA has said that sovereign wealth funds should focus on portfolio investment and not influence management. Recently, chairman of the China Investment Corporation (a US$200 billion sovereign wealth fund) Lou

Jiwei met Swan and Barnett (before the Chinalco and Minmetals bids) to clarify rules on foreign investment in resources and to discuss whether China could help finance infrastructure. Jiwei expressed Chinese government concerns about restrictions on Chinese investment in Australia in the wake of moves to clarify foreign investment policy over the past year.

¶13. (C/NF) Tim Shanahan (formerly head of mining equipment giant CME) told Consul General Perth that while there are community concerns about Chinese investment and the level of Qcommunity concerns about Chinese investment and the level of Chinese investment involved in this deal, he believes these concerns are not "deep." Rio clearly is in dire financial straits and the deal is one alternative to save it. The deal appears structured to ensure Rio Tinto operational control over infrastructure and assets, and make it unlikely that any piece of the company's assets could be peeled off for control by one investor. WA Premier Colin Barnett has taken a hard line with BHP over other issues, and would presumably take a hard look at Rio Tinto's State Agreements in order to prevent foreign control over infrastructure. Shanahan agrees that the deal represents "progress" in what have been, to date, "hamfisted" Chinese investments. He compared it to Japanese corporations' investments where investors had board representation, played both sides of the game, and stayed under the radar. CNOOC is also an example in their negotiation of the Northwest Shelf LNG venture. Shanahan pointed out, however, that Japanese steel mills held the upper hand in price negotiations for years. The Chinalco CEO is apparently very smart, and well-known to many of the WA players. Shanahan sees Rio's argument that the deal will save 2000 Australian jobs as a "sales pitch" playing to the public's fears over the deteriorating economy.

¶14. (C/NF) WA Shadow Treasurer Ben Wyatt told CG Perth that while he had never spoken with Wayne Swan, he thinks Swan will eventually approve the deal because of the economic crisis. In current circumstances, there is great pressure to save jobs, and the Rudd Government will not want to have to answer to public reaction that would come after a disapproval. Wyatt was concerned about the implications of having essentially 18% Chinese control over Rio Tinto resources, including the Hammersley field that is WA's premier resource area.

A STICK OR CARROT FOR FTA TALKS?

¶15. (U) Trade Minister Simon Crean, alluding to the stalled FTA negotiations, this week complained about limits on Australian FDI in China. He suggested that an FTA with meaningful investment provisions would make it easier for the GOA to approve Chinese investments.

THE DILEMMA

¶16. (C/NF) Comment: The spate of Chinese proposed investments in the Australian resources sector suggests that China sees this as the right time to secure greater access to key Australian mineral exports. Swan and the GOA find themselves pulled in several directions in making a call on these investment offers. As the effects of the global economic downturn begin to intensify in Australia, the GOA must keep the short-term interest of preserving jobs and capital inflows in mind, even if Rio's claims of greater job losses are exaggerated. However, among the GOA's longer-term interests is preventing Chinese buyers from gaining undue influence in annual price-setting negotiations for coal and iron ore, Australia's top two export commodities. Maintaining Australia's position as a global resources leader is also a political imperative. If the GOA decides to reject the investments, it will have to find a way to do so without causing a rift with China, its top trade partner - and without undermining its record of promoting and encouraging foreign investment and free trade.
End Comment.